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C O N F I D E N T I A L MOSCOW 003678

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TAGS: [ETRD](#) [EAGR](#) [EINV](#) [ECON](#) [RS](#)
SUBJECT: JOHN DEERE CONCERNED ABOUT HIGHER DUTIES AND
CREDIT CRISIS IN AGRICULTURE

REF: A. MOSCOW 3151
[1](#)B. MOSCOW 2315
[1](#)C. VLADIVOSTOK 135
[1](#)D. VLADIVOSTOK 130

Classified By: ECON Minister-Counselor Eric T. Schultz, Reasons 1.4(b,d
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SUMMARY

[1](#)1. (C) On December 11, PM Putin proposed raising the duties on imported combine harvesters and ending GOR-financing for purchases of foreign agricultural equipment. Deere and Company Russia Country Director Sidney Bardwell told us December 16 that PM Putin's recent proposals would have a catastrophic impact not only on Deere's sales in Russia but also on the Russian farm sector's ability to harvest wheat and maintain the current levels of cultivated land. However, Bardwell said the more modest duty increase proposed by the GOR Tariff Policy Commission headed by First Deputy PM Zubkov was "reasonable" and was a cost that Deere could pass on to its customers.

[1](#)2. (C) Bardwell said Deere's contacts in the Agriculture and Trade and Industry Ministries have indicated that the higher duty and tough financing proposals suggested by Putin may only be applied in limited circumstances. Beyond the unsettled issues of duties and financing, Deere is expecting that its 2009 sales in Russia will drop sharply, and it is scaling back the scope of construction at a new facility in the Kaluzhskaya region.

POTENTIAL DUTY INCREASE FOR HARVESTERS

[1](#)3. (C) On December 16, Deere and Company Russia Country Director Sidney Bardwell provided ECON officer with his assessment of the recent GOR proposals for duty increases on imported harvesters, current financing conditions in Russia for agricultural equipment, and the company's near term expectations for sales in Russia. On December 11, PM Putin proposed raising the duties on harvesters and ending GOR-financing for purchases of foreign agricultural equipment. Putin's comments came while visiting the

agriculture region of Rostov, and the production facility of Rostselmash, Russia's major agricultural equipment producer. Rostselmash has laid off 1,300 workers in the past three months and drastically cut its production for 2009.

¶4. (C) Bardwell said that PM Putin's December 11 proposal to increase the duty on imported harvesters to 120 Euros per kilowatt of engine capacity was roughly equivalent to imposing a 25% ad valorem duty on imported harvesters, a massive increase over the current 5% duty rate. Such a large increase in the duty would have a major negative impact on Deere's and other major foreign producers sales in Russia.

¶5. (C) Bardwell said that the more modest increase in the duty rate proposed in November by First DPM Zubkov's Tariff Policy Commission would be "reasonable," and in line with the duty rates on imported tractors, which are currently assessed at a 15% ad valorem duty rate. Zubkov's Commission recommended increasing the duty on harvesters to 75 Euros per kilowatt for "Walker" harvesters (roughly equivalent to a 15% ad valorem rate) and 50 Euros per kilowatt for "Rotary" harvesters (about a 10% ad valorem rate). Bardwell said that was a cost that Deere could live with and pass on to its customers.

POSSIBLE HALT IN FINANCING OF FOREIGN EQUIPMENT

¶6. (C) Bardwell was equally troubled by Putin's statements that the GOR should cease financing the purchase of foreign agricultural equipment through the three major state-owned

entities that provided agricultural equipment financing in Russia. Farm equipment dealers, distributors and farmers had few other sources of financing beyond the GOR-backed support provided by Sberbank, Rosselkhozbank, and Rosagrolising. If the GOR really limited financing only to purchases of domestically-produced equipment, it would be a "game changer" for the major foreign agricultural equipment producers doing business in Russia (Deere, Case New Holland, Claas and AgCo), and they would sell very few harvesters and tractors in Russia.

¶7. (C) Bardwell said Deere was pursuing a deal with EXIM Bank that would provide financing to Rosselkhozbank for the purchase of U.S. agricultural equipment, and next year Deere would start a pilot financing program for its network of dealers and their customers. These measures, however, would be modest compared to the scale of GOR-financing.

GRAIN PRODUCTION MAY FALL

¶8. (C) Bardwell also stated that Putin's duty and financing proposals, if fully implemented, would precipitate a significant decline in wheat and other grain production for at least one to two seasons. The winter wheat crop was now in the ground, and there would soon be a "tremendous need" for the large harvesters that Rostselmash did not produce. While Russia was currently cultivating 70% of its arable land, that number could drop to 50% in the next one to two years, if Russian farmers were not able to purchase foreign agricultural equipment.

¶9. (C) Putin's Rostov comments, if carried out, ran counter to his oft-stated vision of transforming Russia into a grain-exporting superpower, according to Bardwell. Russia already faces major hurdles in turning that vision into a reality, including poor transportation and ports infrastructure, the lack of silo storage space, and the small scale of most Russian farms. Bardwell noted that Russia had accumulated a 20-million ton wheat surplus in 2008, but it was unable to sell the surplus effectively on world markets, and was currently only getting two-thirds of the world wheat price for this grain. The principle bottleneck was that Novorossiisk, the major agricultural port in Southern Russia,

could only handle three million tons of wheat per month, when operating at maximum capacity.

GOR MAY LIMIT IMPACT OF PUTIN'S PROPOSALS

¶10. (C) In Bardwell's view, Putin appeared "rattled" by the global financial crisis, and in the face of the real impact it was having on Rostselmash and other Russian manufacturers, he had opted for a broad "Brezhnev-style" proclamation while in Rostov-on-Don. Bardwell said his sources within the Ministries of Agriculture and of Industry and Trade had been caught off guard by Putin's "unscripted" statements. (NOTE: A trade disputes specialist at the Industry and Trade Ministry also confirmed to us that the ministry was caught off guard by Putin's proposed duty increase, which went well beyond the Zubkov Commission proposal, and beyond what the ministry was considering as a potential remedy in the safeguards investigation of imported harvesters, discussed in Ref B. END NOTE)

¶11. (C) Bardwell said Deere's GOR contacts had reported that senior officials from both ministries consulted with First DPM Zubkov on December 16 about ways to limit the impact of Putin's broad proposals. For instance, the high duty rate proposed by Putin might not be assessed on large harvesters over 300 horsepower or tractors, since there was no domestic production of either. There was a "desperate need" for both, but especially the larger size harvesters, in order to achieve harvesting and labor efficiencies in the field. Similarly, the proposed financing moratorium also might not be applied to purchases of large foreign harvesters and foreign tractors.

¶12. (C) Bardwell also noted that Deere was considering sending a letter from Deere CEO Robert Lane to the GOR raising concerns about any increase in duties or a moratorium on financing. Bardwell explained that Lane had worked carefully to cultivate a relationship with Agriculture Minister Gordeyev during annual visits to Russia. Likewise, a letter might also come from the foreign manufacturing associations to which the major foreign producers belong. The major foreign producers would also attempt to have their customer base lobby the GOR. However, Bardwell said he was skeptical that customers would want to be out front on the issue. They would not want, in his view, to irritate domestic producer Rostselmash, which would become the only source of supply if foreign firms were effectively shut out of the market by a spike in duties and a suspension of financing.

2009 WILL BE A LEAN YEAR FOR DEERE

¶13. (C) Beyond the uncertainties of increased duties and continued financing, Bardwell noted that Deere was already expecting a sharp drop in sales in 2009, because of a general lack of liquidity and credit in the Russian agricultural sector (Ref B). Globally, he said that Deere's costs for access to short-term financing through the commercial paper markets had increased significantly in the past few months, and the company was in the midst of a major capital expenditure to comply with new emissions standards that would come into effect for agricultural equipment in North America, EU and Japan starting in 2011.

¶14. (C) Within Russia, Bardwell said Deere's "optimistic" forecast was that tight credit conditions would mean that ten percent of the company's dealer network would go out of business before the end of 2009. He said the company had lined up \$100 million in sales for February and March 2009 deliveries that were pre-approved for financing, but that this was down from the \$150 million in pre-approved sales that the company had booked in the same period of 2008.

¶15. (C) Bardwell said Deere's projected sales declines in Russia were on a par with most other emerging markets, including Brazil, and far better than the expected drop-off in sales in Ukraine, where the company's 2009 sales might only be 10% of the sales level achieved in 2008. Still, Deere had a lot of inventory already in Russia on which duties and taxes had been paid. With the expected decline in sales and tight credit conditions lasting into next year, the company could end up with a big overhang of inventory to work through during 2009.

¶16. (C) Bardwell also observed that Deere's plans for the construction of a \$70 million facility in Kaluzhskaya Oblast (Ref B) had been scaled back. The company had broken ground and would continue with the construction of the logistics, operations and training center, but plans for the second phase of construction on a components manufacturing and assembly plant had been put on hold until business and financial conditions in Russia and the rest of the world improved.

COMMENT

¶17. (C) The senior GOR leadership is struggling to find the right approach to the increasingly dire impact in Russia of the global financial crisis. To date, the GOR has been prone to make broad-brush protectionist statements to appease domestic constituents. However, as they have discovered with the proposed increase in automobile tariffs (Refs C, D and septel), these actions create domestic losers as well as winners. A drastic increase in duties and a wholesale suspension in financing for foreign agricultural equipment would severely hamstring the development of Russia's agriculture sector. In that regard, it is worth noting the

irony of Gordeyev and the agricultural sector, enthusiastic proponents of protection for their interests, leading the opposition to protectionist measures for Rostselmash.
BEYRLE